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East European Financial Situation

1. The financial crisis in Eastern Europe is spreading as most of the countries in the area are finding it hard to obtain credits.

- No East European borrower can at present obtain a syndicated Eurocurrency loan.
- Bankers are refusing to roll over some credits as they come due.
- Even the export credit agencies of some Western governments are not willing to increase their lending.
- If credit cutbacks accelerate, Hungary and the GDR, in addition to Poland and Romania, could also face rescheduling by the end of the year.
- Lack of credits will result in sharp import cuts by the East European regimes, which will slow domestic growth and lead to political instability.
- Some regimes may reluctantly turn to the USSR for help, but Moscow will be able to offer little due to its own serious problems.
- Bulgaria and Czechoslovakia do not face serious financial problems this year.

2. The bankers have taken several factors into account in reassessing the creditworthiness of the CEMA countries:

-- the Polish and Romanian crises;

-- growing concern over Eastern Europe's own economic problems;

-- lack of faith in the umbrella theory; and

-- political factors, such as the cooling of East-West political relations, growing fears of political instability in the region, linked in part to Polish problems and fears of Soviet intervention.

3. Where each country stands:

a. Poland's financial mess continues in stalemate. There is no chance that Warsaw can pay the $10 billion debt service bill for 1982.

-- Apparently nearly all interest due to private creditors in 1981 has been paid, and the long-delayed 1981 private debt rescheduling agreement is now scheduled to be signed on 6 April.

-- Potential remaining obtacles include payment of $23 million as a rescheduling fee due at signature and payment of $600-700 million in 1982 interest the banks are demanding before they agree to implement the agreement in May.

-- There is a growing rift among banks, and some US bankers believe that the rescheduling effort will fall apart and lead to default by the end of this year.

-- Western governments have not begun rescheduling talks for 1982 debt relief.

-- Poland has made no payments to the US government since martial law; as of 1 March, Warsaw owed the US $48 million in unrescheduled 1981 obligations and interest on rescheduled amount.

-- The virtual shutoff of Western credits and the need to run a trade surplus to pay interest to Western banks means that Warsaw cannot import the goods it needs to mount an economic rebound.

-- The Soviets, faced with their own financial bind, apparently have not provided Poland any direct hard currency assistance in the past year.

b. <u>Romania</u> requested debt relief in January and faces many of the problems Warsaw has encountered in the past year.

-- Some banks negotiated rescheduling terms with Bucharest last month, but many other banks object to the terms.

-- Disagreements among banks--and consequent delays--are likely over treatment of 1981 arrears of $1.14 billion, short-term debt, and debt to CEMA.

-- Private debt relief is contingent on government rescheduling, but Western governments will not open talks until Bucharest meets the terms of its standby agreement with the IMF.

-- The IMF, however, wants arrearages cleared up before reactivating the standby credit.

Even with successful rescheduling,

-- Romania will have a financing gap of up to $2 billion and, given existing austerity, will have little chance of covering it through import reductions.

-- The persistence of the financing gap means that Romania, like Poland, will be unable to meet the terms of its likely debt relief agreements.

c. <u>Hungary</u>

(1) Hungarian officials have put their 1982 financing needs at $1.5 billion.

-- Budapest estimates that at present it can count on only $600 million from commercial banks.

-- Without further support, Hungary almost certainly would face debt rescheduling by midyear.

(2) Budapest is now trying to line up support from West European central banks to bridge its cash shortfall.

-- The Bank of France and BIS have reportedly reacted negatively to Hungary's request for a $200-500 million loan from central banks through the BIS, the loan would be repaid once Hungary could tap IMF credit facilities.

-- Hungary hopes to cover at least $250 million of the remaining financing requirement by marketing a major syndication in April with commercial banks.

-- The Hungarians anticipate that a loan from central banks and entry into the IMF would restore banker confidence in lending to Hungary.

d. GDR

1. We estimate the GDR's financing shortfall could reach $2-3 billion in 1982.

2. The East Germans have encountered difficulties in lining up credits.

-- Western banks, including West German ones, reportedly have refused to extend new medium-term trade credits.

-- The East Germans apparently have approached West German, French, and Belgian banks about a $300 million balance of payments loan, but final agreement seems unlikely in the near future.

3. The willingness of West Germany to provide more support would be critical to East Germany's efforts to avoid debt rescheduling if the lending cutback persists

-- FRG Economics Minister Lambsdorff recently asserted that lender caution about Eastern Europe should not extend to the GDR.

-- Unless the GDR makes concessions on humanitarian issues, Bonn may reduce the 850 million DM ceiling on the interest-free swing credit after 30 June.

4. Yugoslavia: While not a CEMA member, bankers are concerned about its economic and financial problems and have cut back on lending.

-- Belgrade will probably not be successful in its new bid for a $400 million syndicated loan that was refused in late 1981.

-- Some Yugoslav banks have requested extensions on payments due at the end of March.

-- Yugoslavia has the benefit of IMF membership and could obtain more loans from OPEC.

-- If these sources are not enough, painful import cuts would be needed to avoid serious implications for growth and political stability.

5. Government-guaranteed credits provide some savings to Eastern Europe:

-- A very rough estimate of the Western interest subsidy to Eastern Europe (excluding Yugoslavia and Poland) in 1981 is $500-600 million, equal to roughly 2 percent of the region's earnings from exports to the West.

-- This estimate excludes Poland because Warsaw's substantial arrearages in interest payments on its debt make the question of interest subsidies not relevant.

-- The principal beneficiary is East Germany because it has a comparatively large debt on official and officially-backed credits ($2.9 billion) and because it has access to as much as $375 million in interest-free credit from West Germany (the "Swing" credit).

-- Hungary benefits little since officially-backed debt accounts for only about 5 percent of its liabilities.